01-Jun-2022

Intercontinental Exchange, Inc. (ICE)

Bernstein Strategic Decisions Conference

CORPORATE PARTICIPANTS

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.

OTHER PARTICIPANTS

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

MANAGEMENT DISCUSSION SECTION

Christian Bolu

Analyst, Sanford C. Bernstein & Co. LLC

All right. We'll get started here. Good afternoon to everyone. Thanks for joining for our next session. With me is – I'm delighted to have back again to the conference. Thank you so much for this, Jeff, the Founder, Chairman and CEO of Intercontinental Exchange. So again, welcome back, Jeff. Good to see you in person again and thanks for participating.

Jeffrey Craig Sprecher

Chair & Chief Executive Officer, Intercontinental Exchange, Inc.

Thank you, Christian. It's great to be here. I've mentioned to a number of people I've met today, it's so nice to be in person. This is the first in-person meeting I've done with a big group in a long time, so it's really nice.

QUESTION AND ANSWER SECTION

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Q

Good. So before we get started, just a quick reminder to the audience. You can submit questions through the Pigeonhole system. [indiscernible] (00:00:46) try and ask Jeff at the end of the conversation.

So, Jeff, I mean, there's no other place to talk about here or to start here than, obviously, the mortgage business, particularly with the Black Knight deal. So, I would describe generally investors as running away from mortgage, given, rising rates and all the other pressures going on in the mortgage market. You seem to be doing the opposite of that. You're doubling down on the mortgage business. Kind of what do you see that the market is missing here?

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.

A

It's a good question. Well, first of all, the best time to buy a business is when others don't see the vision and so part of it was just an opportunistic moment in time. Black Knight is a company that we followed and it traded at a multiple higher than our company and deservedly so. And for some reason, the market really pushed down their share price in the beginning of this year, even though we had conviction that they were going to be doing well in this environment. And so others that knew the company I think saw the opportunity and suddenly, there were a lot of inbounds to their management team on offers to do other things. And I think it got their board in a position where they started to think strategically about what would be the best thing for the industry, for their employees and shareholders. And it just allowed us to come together.

Their business, if you don't know it, is largely servicing mortgages, which is levered to the total number of mortgages, which is largely levered to the number of homes and population. And given that there's this big millennial bubble moving through the United States, we can see in our own data that any new home that is constructed is immediately purchased. It has nothing to do with mortgage rates or inflation or what have you. There is just a need for housing. The housing market has been underserved during COVID and with supply chain issues continues to be underserved and there's a backlog of housing coming through that has a TAM for Black Knight that to a certain degree is countercyclical to what the market was thinking was going on inside that company. So, it meshes well with what we've been building really well and we think will allow a lot of cost to come out of the system for consumers that are going to be future mortgage buyers. And so we jumped on the opportunity.

I would just mention to you also that we were pretty versed at doing large M&A transactions and we could see headwinds ourselves in the market obviously. And so seven days after we announced the deal, we placed the debt for that deal. So, we were able to both refinance our legacy debt and put in the new debt, so that we got our own company in a really good position with the fact that the capital markets may change with changes in Fed policy. So, it was also a strategic timing to lock-in the – what we think is a return on investment and get our own balance sheet in a better position going forward.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. Would love to dig more into Black Knight, but can we just go back a little bit here? You obviously spent quite a bit to buy Ellie Mae couple of years ago. How has that business performed relative to your expectations? Maybe it'd have surprised you positive and negatively.

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc. A

It's certainly exceeded our expectations in that – we've had this big refinance bubble that went through that was hard to predict, but put a lot of volume through the Ellie Mae system. So, it allowed us to actually really accelerate the integration of that company and pay down the debt well in advance of what we had planned, and we're very diligent when we do M&A about the schedule on how we integrate and how we manage the capital structure. So, it massively accelerated this bubble that we caught.

And what was interesting though is and we've seen it in other markets which is it costs – now in the United States, it costs about $8,000 or so for a lender to manufacture a mortgage. And that happens whether the mortgage is a $60,000 mortgage or $1 million mortgage. There's a certain fixed cost to manufacture a mortgage. It's largely driven by the regulatory requirements that a lender has to meet, many of which were amplified in Dodd-Frank, but there's also local and state regulation, so depending on where the home is located and if you're a national lender and it just adds to the complexity of manufacturing a mortgage.

So anyway, one of the things that's interesting is we've been automating a lot of that, and you would think that, boy, the market's great. And these folks have automated this manufacturing process, it would become widely adopted. And the reality is when people are making money, even in the old fashioned way, it's very hard to get people to change their workflow. And you actually need a downturn like we have now. And we saw this in 2008 and we saw it – and after the Enron collapsed, where you need some pressure on businesses to change their behavior.

And so, I was surprised at how wedded the mortgage market was to these analog processes. I don't know if you realize that a mortgage in most states is still a required paper transaction with a wet signature, and the documents that go into manufacturing a mortgage are paper documents, and they all end up in a cardboard box with a barcode on them and go to a mini storage warehouse somewhere. And if there is a refinance or, God forbid, a foreclosure, somebody has to go and find that box if the documents present a wet signature to a court. And you can hardly imagine in this digital age where so much of what we do, ordering something online is so second nature now that the mortgage industry is still so box and paper based.

And so, I was surprised that how wedded the market is to that. We've done well. Our licensing revenue is double-digit growth, but you'd be amazed how many people say, I don't need to upset the apple cart when times are good. So I'm kind of looking forward to a little pressure on that market because they really do need to start to automate.

We've gotten about 32, 33 states to change their laws to allow a complete digital market. And so a wet signature is no longer required for foreclosure. And the company we own called MERS is now authorized in most of those states to hold in custody a digital copy of the mortgage, and the digital copy can be presented to a court in a foreclosure and be respected through a bankruptcy process.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC Q

Okay. So speaking of automation and technology, going to the Black Knight call, you seem to be talking about a lot around updating or modernizing Black Knight's tech stack. Can you just talk more about that? What exactly is modernizing? And then maybe any examples of what you've done so far, what you're planning to do with Ellie Mae's technology and kind of how that can feed into the Black Knight conversation?

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.

A

Sure. It's interesting, Black Knight's main platform is a mortgage servicing platform. So after a mortgage has been manufactured and underwritten, it may make its way into that platform, and there it will calculate your property taxes and association fees and send you your monthly statement and calculate whether or not you're on time and et cetera. All that information about the consumer, in other words, the consumer's performance after a mortgage has been written is inside that BlackRock – Black Knight system. And the person that wrote the mortgage may not have any – maybe sort of absolved from knowing how the actual mortgage performed. And so that's because the data that is in one system is not talking to the other system. And our thesis is wouldn't it be great if we could develop a manufacturing system that had all the tools in it for the – regulatory requirements built into it, so that you couldn't fat finger or put the wrong data in.

And what if – when a consumer was buying a new home or refinancing an existing home, the data from the home that they last owned or currently owned could be pulled in to the new mortgage and that doesn't happen now very easily. And so the technology that really the market has been asking for, both the customers and the regulators, is how can we get API calls into that data set and extract information out that can be used to look at the performance of the lenders, of the customers, and of the regulatory compliance and how can that get fed back into a loop, so that it overall collapses the risk and, i.e., the costs in manufacturing a mortgage.

So, the main thing Black Knight has started working on this, but they have a lot of installed on-premises systems that are in large lenders and that have been highly customized. And the real goal is to get APIs that are in all those and extract that data for the betterment of the regulator in the industry and put it back in a central place where it's anonymized and made available to people, and that's what we'll do.

To answer the second part of your question, when we bought the New York Stock Exchange, it was a mess. We completely revamped the entire technology stack. We bought a company called Interactive Data that had 108, I think, mainframe computer installations. We ripped all that out and moved the whole thing into a data warehouse. We're just in the business of taking legacy technology and moving it into common files that we can distribute, build it once and distribute it many times which is kind of what an exchange data platform looks like. And we're really experts in database and distribution technology and that's a bit of that magic that I think we'll bring to the Black Knight team and help them move along.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Q

[indiscernible] (00:12:27) data, how do you think about the opportunity to monetize that data and how should we think about the demand for that data? Is it replace an existing data provider; is it a completely new data sets, new analysis. How do you broadly think about both monetize-in and why a customer would want to buy that data?

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.

A

Yeah. The process of lending on a home – well, first of all, I think many of you here are broadly in financial services and the audience here. And isn't it amazing that we can go on a shopping website and we can buy a completely consumable good? And as we're checking out, something will pop up and say, would you like to buy now and pay later? Like, in other words, I can buy toothpaste, which I'm going to consume over the next few weeks, and somebody will extend me credit, right, and write that credit in real time. And you had a home which is attached to a foundation which has a legal address, which you can see from a Google satellite, which is part of Maslow's hierarchy of needs, provides safety and shelter and will not be abandoned easily by the owner. We take about 60 days and they have 20% [ph] down (00:13:46). And so, there's something wrong with the tech stack that we have in our society now where trivial things can be underwritten in real time and things that actually have collateral value and longevity take forever.

And so the answer to your question is that if you're in a paper-based platform where – I mean you may fill out an application online, but then it's printed out somewhere and somebody grabs a title report which comes through a PDF and somebody else grabs a flood report and I got to go to a credit agency and I've asked you to submit your W-2. And there's all this data that's coming in that's all paper-based. It goes to PDF and back to paper and ends up ultimately in paper in a file. There's no data sharing. And so you have the manufacturing process of a mortgage. The same data is collected different places. And if it doesn't match, it creates an out case. And somebody's got to go through and make it right and figure out what happens. And that is what goes on in that two-month process of writing a mortgage.

And so we believe that the number one thing we can do is put a common network and drive a data standard that eventually will be adopted by the entire industry. The industry has been trying to come up with data standards. But, as you know, industry groups – and we're funding a lot of it, by the way, because we believe in this. But for an industry to coalesce around data standards when their competitive interest and what have you, it's just we found in everything that we've ever built to go from the industry that goes from analog to digital. If we can take a critical mass and drive data standards and make it publicly available, then people will adopt it. Maybe extend it and do other things with it, but we'll at least have the core.

So, the data is just to get everybody that's in the process that already exists working from the same kind of information set, I think it can go much further over time. I think that the consumer debt market is – so, we're building tools for the consumer debt market and the institutional debt market, i.e., the bond market and the consumer debt market, which is – the biggest piece of it is mortgage. And we're building tools to calculate the basis risk between the benchmarks which we list and have businesses around to get that basis risk where we think there's a lot of opportunity.

That data set we think can play into the secondary markets on how the market will price mortgages on the risk that the market can take out of that pricing process. And then also, it's such a major transaction for a consumer. There's just a lot of other people that a consumer might want around that transaction. Baby sitters, lawn care, movers, I mean, everyone that goes into your life decision to buy a new house to the extent the consumer is willing to make that data available, we think it would be highly desirable and would be having positive implications for the consumer. I also think government needs this data more than you think, because there's – we have a lot of talk today about equity in our society and people making allegations about good or bad. And then, the reality is that you need the data to see whether some of these pieces are true or not true or defend your decision making. And I think regulators will be well interested in these kinds of data sets.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Q

Well, [indiscernible] (00:17:38). So speaking of secondary markets, Black Knight should help you develop your products and I think you have a couple of assets that are interesting, things like Optimal Blue. But maybe just talk about what a secondary market platform looks like, what's your vision for that over the next couple years, maybe any way to sort of size how big that opportunity could be.

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

Yeah, sure. So, as I mentioned, we didn't just one day wake up and say we'd like to be in the mortgage business. We're in the interest rate business. We run all kinds of interest rate products on our exchanges in the secondary markets that are used for hedging, and we could see the imperfection between the benchmarks and the consumer in the case of mortgage or the corporation in the case of bonds. And we've been working in that white space between the two to build better hedging tools. That's what this is all about. And oddly, in the case of mortgage, we had to build out the cash market in order to be able to make a better derivatives market.

And so, we have, for example, launched a new index called the Rate Lock future which is the daily – right now, it is a daily rate at which mortgages are locked. We can see that on our origination platform. Until we launched that, a lot of people were working in 60-day or 90-day arrears on what the actual mortgage rates were. And so, we're publishing that daily and we're about to launch our futures contract.

There's a time between when the wholesale market – so, the wholesale markets have these things they call conduit lenders and they'll say to the – ultimate – the primary lender said, give me your next 100 mortgages just as fast as you can in serial order, I want the next 100. Sort of without knowledge of the credit, without a lot of knowledge, they just start doing numbers. And they'll say you have so many days to write those mortgages and give me those mortgages, and I – in exchange for that, I'll lock this rate for you. And as I mentioned, it takes almost two months now to manufacture a mortgage. So, there's a risk between when the customer has their rate agreed and when the capital markets actually see that mortgage. And that's being hedged right now with the current products that are largely US Treasuries. So, there's a basis difference between the credit worthiness of the US government and the credit worthiness of a consumer. And they may move in lockstep until things go sideways, in which case, the consumer credit may go down and the government's credit may go up in the sense that there's a flight to own US Treasuries in times of stress.

So, calculating that basis differences is what we think that this rate lock future will accelerate and we'll get closer to the time. And so, it's new for the industry. It's something that they haven't done before. We published the index for a while now to get them used to it. Now, we're going to launch a contract that they can actually hedge. And the interesting feedback we're getting is people would like that in real time and which we can certainly do at a company like ours with the systems we have, can certainly publish real time indices. We do thousands of them. But their industry hasn't yet time stamped. You can't do something in real time where unless the workflow has you – if somebody does a mortgage in the morning and then submits it in paper in the afternoon, somebody else is digital in the morning, the time stamps are all off. So, we're saying to the industry, work with us on real-time underwriting and time stamping and we can then give you this information in real time and we can continue to take the risk out of it.

I think there are a lot of other products. Black Knight, as you mentioned, has a secondary market platform which it'll be a while before we would get to that because I think the other opportunities are so good. But as we build out those capital markets and risk management tools around the interest rate complex, I mean we own LIBOR and we own many of the global interest rate benchmarks. And we can create those better basis differences and accelerate the real-time nature and then we'll list those products for trading. That's the vision we have long term.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC
Q

It's such an interesting product and it's one that seems intuitively to make a lot of sense. So my question is almost like was it the customers that came to you with this idea or did you – have you been wanting to sell it to them because I wonder what folks had been doing in the past? Was it LIBOR they used to hedge?

[indiscernible] (00:22:47)

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

Right.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC
Q

This opens up an opportunity for you.

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

Right. Well, we don't have an R&D department and what we do have is a pretty flat organization and a distributed management team that works collaboratively together so that we share a lot of information. And so honestly, we started – I think I had the first meeting on this in 2006 or 2007. And then we had the financial crisis which slowed things down and then we were able to buy MERS in probably 2009 maybe or 2010, which is the Mortgage Electronic Registry Service. Then we started building out the ecosystem from there. So, it's been a long time plan. It's not something that just happened one night. But we've always been opportunistic. Everything we've ever bought has been opportunistic in terms of meeting our return on invested capital calibrations and normally, that means there has to be some change in the market where we see something that others don't.

And so, the Black Knight – I think many of you and maybe many of your colleagues have asked me for years, do you want to be in the servicing business and I always said, I don't think so, because – what I was really saying is we can't afford to be in it. It's a hard thing to organically build given everything else we have going on. It's something that we get to way down the road. But when the opportunity falls in your lap, we're the kind to do that.

I didn't start ICE because I one day said, I'm going to go do this. The opportunity kind of came. I was living in California. I was running another company that I had started. And this thing kind of came and it was in Atlanta and I thought, who the heck would ever want to live in Georgia. And I mean – but in life, it was like, well, you know, that's kind of an interesting opportunity and you got to seize it. So, I tell you that just because the DNA of making your own luck and being in right place and being prepared when things come along and acting on them has been in the calculation of this company since we started it. And I think those that may have owned Black Knight that sold it made a mistake because it was up 9% in the first quarter when volumes were down 40%. In other words, I think people miscalculated the correlation to hit the interest rate market.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC
Q

Speaking of deals, when you think about your vision of the mortgage market, anything else missing that you've got to go buy in the next few years, buy Zillow or something like that? How do you think about what's missing here?

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

[indiscernible] (00:25:39) think we should be buying houses with an algorithm. By the way, we like to provide data for people that have algorithms, that's actually part of our thesis as there will be others with algorithms. No, we don't have to buy anything. It's more of – we're in a luxurious position to be a global company with wide distribution and a good reputation and a very good core business that we've built to really be kind of an all-weather business. And we had the best quarter ever last quarter, and the fourth quarter before that was the best fourth quarter we ever had in our history. And you can see our – the data we publish on a routine basis, we're doing really well. So, we're in the business of helping people manage risk. And when there is risk in the world, we tend to do well. And so, we don't have to do anything. It's more of being in a position in life that if the right thing came along and it's additive to your mission that you can act on it and the market has over time given us permission to do that. And we're pretty disciplined in what we do.

And so, we don't have to do anything, but we always keep our eye open. To be more truthful about it, we meet every two weeks: inside my company we have a team, meet every two weeks. We go through, you know, what others are doing, what competitors are doing, what companies may be available, what bankers are telling us may happen, you know, where we are in our own roadmap, and what our return on invested capital looks like, what our capital costs are, what the benefit of buying back stock versus raising the dividend. Like, we have a disciplined process two – every two weeks. And so, it's not like when an opportunity presents itself, we – you know, we have to be startled.

We, you know, announced Black Knight. We placed $8 billion worth of bonds within a week. Okay? That was: organize the bond issuance, bring the banks in for due diligence, have the rating agencies come in and rerate us, figure out what we're going to do with the outstanding debt, test the market and place them. Seven day – our bankers told us, like, we've never seen that ever. But, you know, that was part of being prepared to seize opportunity.

Christian Bolu Q
Analyst, Sanford C. Bernstein & Co. LLC

Must also have a good CFO.

Jeffrey Craig Sprecher A
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.

Yeah. Good CFO. He's here already...

Christian Bolu Q
Analyst, Sanford C. Bernstein & Co. LLC

Okay.

Jeffrey Craig Sprecher A
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.

...so I'll – I'll say yes.

Christian Bolu Q
Analyst, Sanford C. Bernstein & Co. LLC

Regulatory risk of antitrust, always very hard to analyze. I still don't understand how CME bought CBOT, but, you know, these things happen.

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

I was on the other side of...

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC
Q

Right. Yeah.

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

...you know, at the – with the same calculation you had.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC
Q

And you guys have had some troubles in the past, right? Like you couldn't get the [indiscernible] (00:28:39) deal done.

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

Yeah.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC
Q

So, why – how are you confident that you can actually get Black Knight across the line? There is some skepticism around concentration risk, et cetera. So, just curious on what gives you confidence that this really gets through?

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

Well, we – we worry about that, too. And I'm sure the regulators and people are going to look at this – you know, think about those things deeply as well. But what we did is we said to ourselves, before we do a major transaction, we better be pretty sure. So, we told the Black Knight team, we weren't prepared to go ahead with the deal unless we would – had absolute confidence that you know, this was lawful and legal and in the best interests of the industry. So, we got them to agree to create a clean room. They hired a third party. We hired a third party. We put all of the information – competitive information we could think of into that clean room, asked them for their competitive information. And they had their party, we had our party go through everything independently and give us a view on what – where they thought overlaps might be and how the market would view this, how regulators would view it, what's lawful.

And both parties came back and then told us that they thought this was imminently doable, that there was very little of any overlap, that it was perfectly lawful and it was good for the consumer and good for the industry. And so, it gave us a lot of confidence. So we've done a lot of that work already ourselves before we even announced the deal.

Again, we were prepared. We're always – we understand, having been through good and bad situations, we've – are knowledgeable and have a really strong team and we're able to show the other side a tremendous amount of data: board minutes, presentations, proposals we had made to other customers, outcomes of various deals, all went into that clean room.

I don't know – from a competitive standpoint, I don't know what's in that because we had third parties analyze it and we still, you know, don't have approval, so we – there's no gun jumping going on here. But we took a lot of confidence in the people we hired to really rip it apart.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Q

Do you think the consumer benefit aspect is helpful here? I think everyone intuitively understands that if you can make the mortgage market more – you know, more digitized, that benefits everyone. Does that help at all in that argument with the anti-trust guys or no?

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.

A

Well, it's – you know, just to me as a manager, you have to step back and say, yes, the US regulator, is the goal to protect the largest lenders. They worry that the largest lenders can't figure out how to buy and acquire software and build lending systems and consumer engagement, or are they worried that the largest lenders aren't making, you know, lower cost mortgages available to consumers?

And, you know, we're a large financial services company as it is. And the large lenders and financial services players, including many of you in the room here, have multiple touch points to us across multiple different asset classes. And the notion that somehow we can get away with something with large financial services companies that don't have the ability to put pressure on us from a competitive standpoint is laughable.

I really do believe, this is about the consumer. And I think a large part of the cost in that space is government saying, we want lenders to do and comply with certain things. There are regulations that were put on, many of which after the last financial crisis. But they also expect that, you know, lenders are going to do that cheaply and efficiently and with data integrity and with honesty in terms of how they consider those loans. And that can only happen with more interoperability and better data.

Right now, a lender can – and they do: they buy whatever they need a la carte, and there are dozens and dozens of things that – we have 1,400 vendors on our loan network providing various services to manufacture that loan. And, you know, the notion that there isn't competition and that big, you know, lenders that have market share and even the fintech startups there really do innovative things that they need help is – we just don't see it. And we don't see it in the data either when we print in the clean room.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Q

Cool. Well, believe it or not, mortgage is not your biggest business, so let's move on...

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.

A

No, I know. It's an interesting one, but it's...

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Q

...to other things here. So, maybe on the energy markets – we had a lot of stress within energy markets. A lot of commodity players are having problems funding their positions, given just high prices, high volatility. Curious from where you sit what you're hearing and how you think ultimately this sort of environment impacts your energy businesses over the next few years.

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.

A

Yeah. It's interesting. So, there are – a risk model that calculates margins looks at both absolute price, but more importantly, it looks at the single daily price move. So, when a war starts, and particularly when government is making decisions about imports and exports of energy, can have very large single-day moves, unexpectedly large moves that impact margin. And so, when the conflict started in the Ukraine, there were large price moves and reactionary moves which you would expect in the markets that raised the margin rates: and that did impact, in the beginning at least, some strategic customers that were trying to hedge their supply and production.

Anyway, what we saw was kind of some interesting movements. Markets ultimately are very efficient, and we saw a number of players move to the option markets as opposed to the outright markets. So, in an option market, you are hedging a range of outcomes, whereas in the flat price markets, you're hedging a specific outcome. When you hedge a range of outcomes, you can control more outcomes at – for a lower price if you will – lower unit price, but you have less precision. So, you know, basically you're hedging your tail risks as opposed to your absolute price risks.

And so, we saw a movement in options. You've seen that in almost every asset class, not just in energy, but in equities today, the options volumes are way up. You see a lot of meme stock traders are no longer trying to pick the price of a company; they're working on tails, right. And you've have seen that across a whole range of asset classes where there are volatility.

The other interesting thing is, we had a lot of European players that – so, the European government – and as you may have seen yesterday, put a further point on it. Europe is still using a lot of Russian energy. It's still lawful. It's still encouraged. And – because the politicians there and the regulators there want to keep those economies going. But there are a lot of, you know, actors – commercial actors in the space that say, I don't care about what the policy is. I don't want to – I have my own moral and ethical reasons for not wanting to participate with Russia. So, we've seen a lot of Europeans buying US gas and power, for example, as a hedge. It's not a perfect hedge. Obviously, there's a basis difference between geographies and the fact that there is limited US exports of both gas and oil. But it's better than being, you know, naked as a hedge. And so, we saw kind of a global rotation too.

And what we're seeing now is more definition by governments as to what is and isn't acceptable and more of a road map on where Europe particularly wants to go in the future. And underneath that, we've seen index providers, our own products start to coalesce around, either Russia's fuel is in those products or not in those products. And people are having more choice and – - in how they hedge; less uncertainty. And so, we see a movement back to – out of options, back to flat price and out of the US, back to Europe. I think that will continue to happen as Europe become – you know, has a more cogent, long-term strategy.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Q

I think long-term implications for your business – when you think about maybe Russia coming out of the market, over the longer-term, what does that mean for the product sets you have, your broad energy business?

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

Yeah. Well, first of all, we didn't have any Russian clients, and there were no Russian banks who were members of any of our clearinghouses. So, any impact is harder for us to see. It's a second order – like, to the extent they were somehow in our markets, they were through intermediaries that we didn't have direct vision to. But, you know, I do think that what you're going to see is – I don't know, we're – we had a strategic meeting on this yesterday, so it's kind of top of mind. But we haven't seen significant demand destruction at these higher prices. There is some at the margin, but when you're talking about Europe, say, taking – you know, some countries, 35% of their energy from Russia, they – they are – by the market and by the governments is that to the extent they don't want Russian energy, they're going to have to replace it with some other energy quickly.

And so, we're seeing in Europe, there's gas up in the Scandinavian area. We're seeing gas that used to be sort of localized up there, people trying to figure out how to move that to the east and south. We're seeing barges that are – we're in Rotterdam, where there's fuel, and trying to figure out how to get down the Rhine to Germany. So, we're kind of seeing this different supply chain shift. And I suspect what that really means is that Russian energy will make its way into China and other parts of Asia. So, it's kind of a re-shifting of the supply chain.

But oddly – and maybe we see it: I'm an American in – living in the States and we see higher prices here, and we haven't seen huge amounts of demand destruction yet. I'm not sure either the US or Europe has seen the full impact of those prices. We've been somewhat buffered. You know, utilities tend to have long-term agreements, and so prices don't get immediately passed through to the consumer. I think we are worried about, you know, coal – the coal parts of the US and Europe next winter, where some of those long-term agreements will have rolled off and some of those prices will be pushed through to consumers. I think that's why you see the UK thinking about, you know, a transaction tax that will – or a windfall profits tax that will reallocate. We may see more of that kind of talk, particularly in Europe, because I think it's going to be hard for that supply chain to move that quickly even though there are barges and tankers and pipes and liquefaction facilities that, you know, can do some of that that exist already.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC
Q

Okay. Let's switch topics to a hot button topic in the industry just now...

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

And by the way, Jamie Dimon can tell us – you know, I – he's an amazing guy, so he has a better vision as to what to look forward to than I do.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC
Q

He is a [indiscernible] (00:41:27)...

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

Yeah.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Q

... industry that's hot topic issue just now is FTX, the Crypto Exchange, [ph] trades to (00:41:34) a direct clearing model. The CME has been vehemently opposed to that model. And I'm curious your view and – you know, part of the reason why I'm curious your view here is, I kind of feel – I see Sam Bankman-Fried who is the CEO of FTX as kind of a maybe younger version of yourself, someone actually doing something innovative in exchanges. This is a very [ph] state industry (00:41:58) with lots of history, and things don't move a lot to someone to actually being somewhat innovative. And I am surprised at the level of resistance that the incumbents have put in front of him. So, curious what your view is.

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.

A

Yes. So, I don't disagree with you, by the way. And someday, after all the confidentiality agreements go away I'll talk about eBay. But that was a early – maybe one of the earliest direct-to-consumer engagements of an exchange. And what FTX has – and Coinbase and Robinhood and others in the fintech world have basically gone direct-to-consumer. And I think many like to say, well, they've cut out these brokers and middlemen that weren't providing any value.

But the reality is that the entire body of regulation that ICE is subjected to both in securities and in commodities contemplates that there is an intermediary. The – all the know-your-customer and anti-money laundering obligations that exist right now in the US and European capital markets assume that there is an intermediary who is doing that work, not the exchange. And similarly, the – and by the way, the reason there is no such thing as New York Stock Exchange direct is that the only one who can access the New York Stock Exchange has to be a registered broker-dealer in the United States. So, I mean, it's not that we're stupid and that we couldn't do NYSE direct: we have lots of technology and systems. It's not even legal.

And the same thing happens on the – on the clearing and settlement side. It – the way the model is designed to work – and this is globally really, and it got enshrined after Dodd-Frank and EMIR in Europe is that – is that the members of the clearinghouse are basically lenders. And they have to be the ones that do the – to the extent those are default, the work-out of that default has to first be done by a lender before it hits the clearinghouse. And so, none of the obligations and regulations that we're subjected to allow us to bring in a direct consumer. They don't allow us to do a direct liquidation.

And so, the argument we're making is not that – that we're right, or he's right, or somebody else is right or wrong: we've just said, the whole body of law that exists today doesn't contemplate this. And if you want to change the law, then let's change it, and let's all be subject to it. What's – the conversation that's been going on right now is can we take – can all the incumbents be subject to the existing law, and can we find some use cases where we carve out for certain kinds of things, you know, a different way of doing it? And the – and our answer is, well, if that – if that works for that, why wouldn't that work for everything? Like why – you know, it either works or it doesn't work. And so, part of the stress test that we go through in clearinghouse is it's not just stress-testing us, they stress test all the clearinghouses and all the major financial services companies and see how we all interact. And part of that is there's a lending layer in there that buffers the liquidations, if there are liquidations.

And, you know, certainly we could either computer program that would liquidate somebody automatically and everyone else could write that program. We would all liquidate at the exact same – if it's a onesie or twosie, no one would ever know it. In a flash crash situation or a Lehman situation or a bear situation, if everyone's liquidating at exactly the same time on an automated fashion, there's no buffer in the system, and that has not been stress tested. And maybe it should, maybe not, but this is the debate that I think we're having.

So, anyway, we're part of the conversation. I don't disagree that technology can take things directly to a consumer. And to a certain degree – I've just talked for 20 minutes about streamlining the mortgage process to the betterment of the consumer and giving the consumer more tools and information to make informed decisions.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC
Q

Okay. We're running out of time. So let me jump into a couple of investor questions. First one is how do you think about normalized growth potential for your exchange business across futures and equities and options?

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

Yeah. I think, you know, we look internally that we want to have a – like, when we do M&A, you know a return on invested capital of well above our cost of capital and we tend to target, you know, a 10% or a double-digit ROIC. And so, as we calculate every two weeks our own cost of capital on what-have-you, the growth of our businesses is what's playing into that modeling. And so I think that my job as a Chief Executive is to give you double-digit EPS growth. And there's two ways to do that: have very high top-line growth or really control – build a platform that you build at once, and a single-digit growth will drop double digits to the bottom line. So, I think about – I really think about how we get to double-digit bottom line growth, and same thing with free cash flow.

What's amazing – and I'm not going to give you guidance – but what's amazing is that the products that we started the company with, now 20 years ago, still are delivering really good growth. Maybe what's more amazing – and I mentioned this in one of my breakouts earlier today is that the New York Stock Exchange was started in 1792. So, it's 230 years old. And in the last two years – okay, for 230 years, it grew the US equity markets. In the last two years, trading doubled. Okay? 230 years to get to a point: in two years, it doubled. Our options business at the New York Stock Exchange is up – last quarter, 30-some percent, 34% maybe.

I don't know: you know, if you were to ask me, how would I feel about a 230-year-old market doubling? You'd be, wow. So, it surprises me as – it still surprises me to this day, as you broaden access and lower cost, how these things can find tentacles. And I think that hedging energy for example – which is at the root of the question, which is sort of our earliest products – it was surprising to me that just, you know, seven, eight years ago the airlines didn't – were selling tickets that were – largely levered the fuel prices and they didn't hedge which is weird because that was a – you can perfectly hedge a forward ticket price. They're doing that now. And we're now seeing hedging can, you know, continue to broaden the types of people using it.

I think the energy crisis, predominantly in Europe right now is going to accelerate a widening of people that feel they need to hedge. And, you know, in the case of FTX and others, they're starting with, we can get consumers on apps, even ride-sharing people and people that are food-ordering, people are – that are – they're saying, well, maybe the guy or girl on my app wants to buy a stock or borrow mortgage or – I mean, everybody that has a consumer app is seeing this thing broaden. And I don't think that we're too far away from, you know, broadening of the energy space so that at least large industrials and others are forward-buying their energy.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC
Q

We're out of time. But I'm still going to ask you one very last one.

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

Sure.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC
Q

So, you only got [ph] about (00:50:30) 30 seconds to answer it. And the question is really on stock. I think you make a compelling case. The business is very diversified. It's still growing double digits, levered to many secular themes. Yet the stock trades at a meaningful discount to some of your peers in exchange world and certainly peers in the data world. What are investors missing? Like, briefly.

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.
A

You know, when we started ICE, people said, of course you can trade stocks online, but you can't trade commodities online. And then when we went to start a clearinghouse, which is a very strategic asset, people said, well, why would you buy a clearinghouse? You can – you can do clearing for $0.05 a contract. Why would you ever build something like that that's such a utility?

And, you know, when we went into the corporate mortgage hedging space by buying Interactive Data, was – was the primary move into that space. It had been historically growing at 3%. We said, we think we can at least double the growth of that. And people said, why – why [ph] can't (00:51:38) you do that? That's been around forever and bonds have been around forever. So, I guess what I'm saying to you is usually when we are moving into a strategic direction, the market doesn't believe it, doesn't see it. And I don't think it's the job of the market: like that's my job, you know. It's, on behalf of you as investors, to redeploy capital in a way that will provide long-term value.

And I don't expect you to sit around and see the same things I see. I mean, I get paid a lot of money to do that every day, every minute of every day. And – and so, you know, I just think it takes time. So – I mean, I don't know, we're not particularly fussed by it. We really think we're – we're on to something, we're going in the right direction. We're very, very positive about it. And the business itself, I mean, we're – we're really doing well. And so – I don't know, we may have to prove that for a few quarters. Hopefully, it won't take too many quarters. But I know we're doing the right thing.

And I know that at the end of the day, what we're doing is going to build free cash flow and – and be a great return on investment, and that's all I can do as a manager. And then you have to figure out – you know, Christian, how to tell people that that's a good value in the stock market.

Christian Bolu
Analyst, Sanford C. Bernstein & Co. LLC

Fantastic. Good place to end it. Thank you very much, Jeff.

Jeffrey Craig Sprecher
Chair & Chief Executive Officer, Intercontinental Exchange, Inc.

Thank you, guys.

Christian Bolu

Analyst, Sanford C. Bernstein & Co. LLC

Thank you.

Jeffrey Craig Sprecher

Chair & Chief Executive Officer, Intercontinental Exchange, Inc.

Thank you all for [indiscernible] (00:53:02).